

Audit Responsibilities And Contract Closeout

**A Self-Study on Contract
and Financial Assistance
Closeout and Audit Responsibilities**

U.S. Department of Energy

Prepared for the
Chief Financial Officer

Financial Management
Development Program

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Introduction

About This Self-Study Guide

This self-study guide is designed to assist Department of Energy (DOE) financial management and procurement personnel in understanding the audit and closeout requirements for the various DOE procurement instruments.

This self-study guide is intended to assist the reader in understanding the following processes:

- Audit process and audit cycle.
- Different types of awards and their individual audit requirements.
- Different types of entities, including their individual structure, applicable cost principles, and audit requirements.
- Application of indirect rates, including what they are, how they are computed, audited, and negotiated.
- Award closeout processes.

Target Audience

- Accountants and Financial Review Personnel.
- Reviewers.
- Procurement Personnel.

Prerequisite Knowledge and Skills

- A general knowledge of accounting and auditing practices and procedures.
- A general knowledge of procurement practices and procedures.

Structure

This guide consists of four modules covering the following topics:

- Audit process cycle, types of awards, and audit requirements.
- Types of entities and their applicable cost principles and requirements.
- Indirect rates.
- Closeout.

Instructions

This self-study guide should be completed in sequence starting with the Module 1. Begin each module by reading the objectives and proceeding with the subject matter presented. Although the training does not require an exam, we invite you to complete the self-test at the end of each module to evaluate your understanding of each subject. An answer key is also provided at the end of each self-test.

Module 1

Audit Process Cycle, Types of Awards, and Audit Requirements

Objectives

Upon completion of this module, you should be able to do the following:

- Understand the audit process cycle.
- Identify the different types of awards.
- Understand the audit requirements.

Estimated Completion Time

2 hours

The Audit Process and Audit Cycle

Audit Process

The audit process is a cyclical event that begins at contract award and ends 2-5 years after expiration of the award. Most awards, whether a contract or financial assistance and whether with a commercial entity or a non-profit entity, require some form of audit. The audit cycle includes an annual audit of direct and indirect costs plus some type of final audit or final reconciliation of costs.

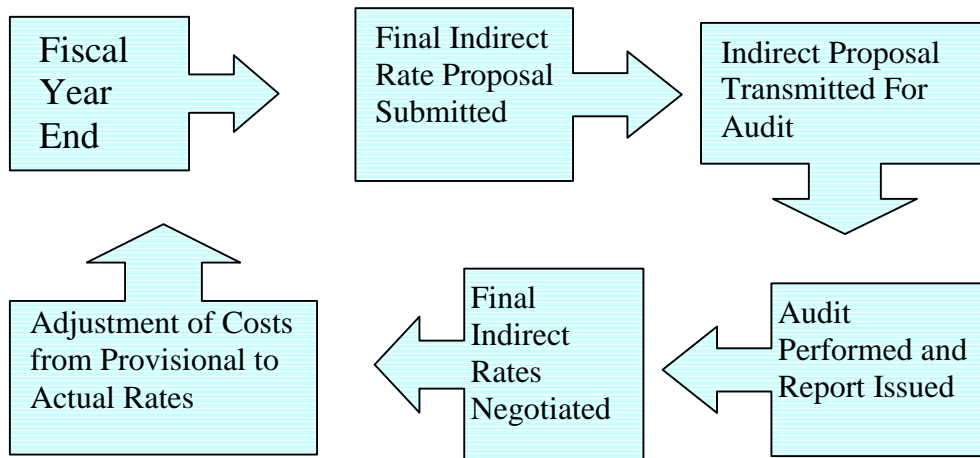
An audit is necessary for the Government to have some assurance that the price is reasonable or that the costs are allowable, allocable, and reasonable. The type of audit depends on the type of award. For example, noncompetitive fixed-price contracts, time and material, and labor hour contracts generally require audits during the pre-award phase. Any post-award audits of these contracts would be very limited, such as the verification of payments made to contract terms for price, negotiated changes, labor rates, etc.

On the other hand, significant post-award audit effort is required for cost reimbursement contracts, grants, and cooperative agreements prior to the acceptance of the costs. These types of awards require annual negotiation of final indirect rates and annual audits of costs incurred. Also, it should be noted that some award recipients are required to have a certified public accountant (CPA) financial audit. However, the CPA audit is different from a cost reimbursement audit in that its purpose is to certify to the fair presentation of the financial statements and the cost reimbursement audit is to determine the allowability, allocability, and reasonableness of costs charged to the Government.

The remainder of this section deals with the audit cycle relating to cost reimbursement and financial assistance awards.

Audit Cycle

Audits cover the awardee's fiscal year (FY) cycle and not the funding year or the Government's FY. The timeliness of the audit is dependent on the cooperation of all parties involved. The audit cycle is as follows:



The number of audits conducted will depend on the length of the award. A 5-year award will need 5 years of audits. Additionally, after the indirect rates have been audited and negotiated for all years of the award, a final audit is required.

The final audit process is initiated after the final voucher is received. The final voucher represents the total claim against the Government. The final audit is a compilation of all the previous years' audits and a reconciliation of billed costs to the final recommended costs (based on the audit reports). *The Contract Closeout process is discussed in detail in Module 4.*

Types of Audits

Generally, there are two types of audits, the site audit and the desk audit. The decision to use either type depends on the following factors:

- Prior audit history of the entity.
- The size of the award.
- Whether the entity has other Federal awards.
- The timing of the audit cycle.
- Cost benefit of obtaining an outside audit.

Generally, smaller awards (less than \$1,000,000 or \$500,000 annually) are audited by a desk review rather than a site audit. Another factor to consider is whether other Federal audits are being performed at the recipient's location. In which case, it may be more cost effective to the Government to request a site audit on the smaller awards. On the other hand, if the award is small and there is no other Federal audit presence, it is generally more cost effective to perform a desk review.

The Site Audit

The DOE Inspector General (IG) has responsibility for all audit activities within the DOE. However, in order to focus its resources on areas other than costs, the IG made a decision that it would not perform cost reimbursement audits. DOE Headquarters (HQ), therefore, entered into a memorandum of understanding (MOU) with various Federal audit entities, including the Defense Contract Audit Agency (DCAA), Department of Health and Human Services (DHHS) and the Environmental Protection Agency (EPA) to perform the cost reimbursement audits for the department. DOE reimburses these audit entities for their audit services, therefore, consideration should be given to the cost of the site audit in relation to the benefits to be derived from the audit.

If a decision is made to request a site audit, the first step is to determine which audit agency has audit cognizance. Generally the

DCAA will have audit cognizance for commercial entities and the DHHS will have cognizance for educational institutions and some non-profit entities. It may not, however, be necessary to request an audit for the educational institutions and non-profit entities because, under Office of Management and Budget (OMB) Circular A-133, they are required to obtain their own audits.

In special circumstances, there may be other agencies that have cognizance over an entity. In cases where another agency has audit cognizance and there is no MOU with that agency, DOE HQ, Office of Procurement and Assistance Policy should be contacted for assistance.

Defense Contract Audit Agency

If the decision is made to request a site audit and the DCAA is the cognizant audit agency, the initial request for audit should be transmitted to the cognizant DCAA branch office as soon as possible so they can properly plan for the audit. The DCAA is divided into five regions, each of which has numerous branch offices. The DCAA issues a directory, which contains the address and telephone number of the various DCAA regional, branch, and suboffices. Audit entities are assigned to the various DCAA offices by the entity ZIP Code. The DCAA directory is also available at the DCAA Internet site located at <http://www.dtic.mil/dcaa/index.html>.

Any special circumstances or concerns about the audit entity should be transmitted to the DCAA at the time of the request. It is also a good idea to talk with the DCAA auditor in charge to discuss special issues that you want the auditor to review. Additionally, audit requests should be tracked to ensure receipt of the audit reports.

In addition to the initial request, a copy of the final indirect rate proposal, along with a request for audit, should be transmitted to DCAA when the final indirect rate proposal is received. It should be noted that DCAA will track the receipt of the yearly indirect proposal for the larger companies and entities that have a constant DCAA presence. Many times the DCAA will receive the indirect proposal directly from the entity. Therefore, you should contact the appropriate DCAA office to determine if they have the proposals prior to sending them to DCAA.

Desk Audit

The desk audit or desk review is a true audit and should be performed by someone who has auditing knowledge. The only difference between a desk review and a site audit is the location at which the audit is performed. The desk review or audit should follow a written audit program, and the DCAA contract audit manual is a good resource to use in developing contract audit programs. The DCAA Internet site (<http://www.dtic.mil/dcaa/index.html>) provides general and specific information and sample audit programs for various areas of contract audit. Since most desk reviews are performed on smaller dollar awards, the sample standard audit programs will generally have to be modified.

In planning for the audit, the reviewer should obtain a sample of supporting documentation of costs incurred (such as labor distribution worksheets, timesheets, invoices from subcontractors or for equipment purchases, etc.) for verification. Also, costs billed should be reviewed for allowability, allocability, and reasonableness. The following actions are necessary to complete the review:

- Schedule vouchers by cost element and the entity's FY.
- Obtain copies of the annual final indirect rate proposal, annual Federal tax return, and annual CPA financial audit (if available).
- Reconcile the indirect rate proposal to the entity's Federal tax return, CPA financial audit, or general ledger.
- Perform review.
- Write and issue report.

Caution: *If you find significant issues and problems while performing a desk review, you should either expand your sample or, if the issues are serious, stop the desk review and request DCAA to perform an audit. DCAA should be informed of your issues, and you should specifically address any concerns in the request for audit.*

Types of Awards and Audit Requirements

The type of audit depends on the type of award. Each type of award has its special circumstances and must be audited differently. Also, each type of entity (commercial organization, non-profit, educational institute, or state and local government) has different cost principles regarding the allowability of cost. A discussion of the types of awards and applicable audit requirements follow (the types of entities and varying cost principles will be addressed in Module 2).

Time and Material and Labor Hour Contracts

Description

Time and material and labor hour contracts are used to buy time at a fixed and specified hourly rate that includes direct labor, indirect costs, and profit. Also, the actual costs of material purchases are allowed under time and material contracts. Labor hour contracts are the same as time and material except that materials are not supplied by the contractor and are not reimbursed.

Audit Responsibility

Most of the audit work is performed during the pre-award stage of the contract in order to establish the fixed hourly rates (which include labor, indirect costs, and profit). However, time and material or labor hour contracts have specific concerns that require some post-award audit review. The following areas of the contracts require post-award audit:

- Other Direct Costs and Materials – Under time and material contracts, other direct costs (if allowed by contract) and materials are reimbursed at cost in accordance with the applicable cost principles. Therefore, some audit in these areas is necessary prior to final acceptance of costs.
- Labor – Although time and material contracts and labor hour contracts provide fixed labor rates, audit is necessary in order to ensure the following:

- Hours billed agree with the contractor’s time recording records.
- Labor categories billed agree with the labor position used for the work. Special emphasis should be made to ensure that the contractor does not “switch” labor qualifications by billing a higher labor category than was actually used.
- Defective Pricing – Since the labor hours are fixed based on cost and pricing data submitted by the contractor prior to award (and relied on for negotiations), time and material and labor hour contracts are subject to defective pricing.

Cost Reimbursement Contracts

Description

Cost reimbursement contracts provide an array of flexible financial arrangements that are essential to afford the contractor a guarantee of some degree of cost reimbursement when they agree to undertake work where the scope of the work cannot be estimated accurately. The cost reimbursement contract takes on many different forms as highlighted below:

- Cost Contract – This is the simplest form of cost reimbursement contract. The contractor receives reimbursement for its costs, but no fee is provided. This type of arrangement is generally used for educational institutions and other non-profit entities.
- Cost-Participation Contract – This contract provides for the Government to reimburse the contractor a portion of **allowable** costs. It is also sometimes termed a cost-sharing contract. Fee is generally not allowed under this type of arrangement since the contractor is “contributing” to the overall scope of work.

Attention to the contract terms and the contract language is essential in these arrangements since the type of “sharing” may be costs, in-kind contributions, cost matching, cost limitation, or

other arrangements. (See the discussion on Cooperative Agreements regarding cost sharing and in-kind contributions).

- **Cost Plus Fixed-Fee Contract** – This contract provides for reimbursement of actual allowable and allocable costs of performing the contract plus a fixed fee.

The recommendation of fixed fee is generally outside the assist audit scope of work. The contractor is entitled to the fee stated in the contract. The only exception is for level of effort contracts that have specific terms and conditions that require an adjustment of fee. The general conditions require an adjustment of fee should the contractor under run or over run the number of direct productive labor hours by 10 percent or more. Care should be taken when analyzing a level of effort contract for these fee terms.

- **Cost Plus Incentive Fee Contract** – This contract provides for reimbursement of actual allowable and allocable costs of performing the contract plus an incentive fee arrangement. In an incentive fee contract, the contractor is provided an additional incentive to accomplish an established objective. The fee schedule is established to provide for a maximum and minimum fee that is due the contractor depending on the objective. The contracting officer may request assistance in computing the fee based on the objectives. However, as stated above, fee is generally outside the assist audit review scope. The contracting officer, in the case of incentive fee contracts, is looking toward the analyst to provide data regarding the allowability and allocability of the costs.
- **Cost Plus Award Fee** – Most cost plus award fee contracts are management and operating contracts that are not covered in this study guide.

Audit Responsibility

Cost type contracts require considerable audit effort since total costs (direct and indirect) claimed must be audited for allowability, allocability, and reasonableness.

Fixed-Price Contracts

Description

A fixed-price contract is an agreement by the contractor to furnish specified supplies or services at a stipulated price. This type of contract places the risk for performance solely on the contractor. These types of contracts are not subject to adjustment for over or under estimating price.

Auditing Responsibilities

Post award auditing of fixed-price contracts is limited to changes due to the nature and scope of the work contracted for and/or suspected defective pricing. Defective pricing occurs when a fixed-price contract is awarded based on negotiations and the data provided by the contractor, which was “relied” upon by the Government during negotiations, is false. In these instances, the Government is allowed to request reimbursement for the *difference* between what the price would have been had the information been accurate. There are special circumstances following defective pricing which will not be discussed in this study guide. Generally, the DCAA is requested to perform a defective pricing audit.

Fixed-price contract changes are usually negotiated and as such are generally treated similar to “cost-type contracts.” Equitable adjustments due to a contract change may or may not be audited. The decision for audit is the responsibility of the contracting officer.

Financial Assistance Awards

Description

Financial assistance awards include grants and cooperative agreements. Financial assistance awards differ from contracts in the amount of administration, reporting requirements, and other “contractual” requirements. The basic philosophy behind financial assistance is to provide a means of contributing financial resources without the administrative burden (both from the recipient and the Government’s standpoint) that is required under contracting.

A grant places DOE in the position of a “patron” for stimulating or providing financial assistance in supporting an organization with minimal DOE involvement. Although DOE receives benefit, the overall purpose of a grant is to benefit the public.

A cooperative agreement on the other hand is viewed as placing DOE in the position of a “partner” in the financial assistance relationship. The major difference between a grant and a cooperative agreement is the fact that under a cooperative agreement, DOE is “substantially involved” whereas DOE is not in a grant. Cooperative agreements generally involve cost sharing which is discussed later in this section.

The following are some helpful web sites for financial assistance awards:

Description	Web Site
DOE Guide to Financial Assistance	http://www.pr.doe.gov/gf1ti.html
10 CFR 600	http://www.pr.doe.gov/f600toc.html
DOE Financial Assistance Page	http://www.pr.doe.gov/fahome.html
Grants Web Page	http://web.fie.com/cws/sra/resource.htm

Audit Responsibility

The audit responsibility is the same for financial assistance as for contracts. The type of entity that receives the award determines what type of audit responsibility is required. Educational institutions, non-profit entities, and state or local governments all follow OMB Circular A-133 audit requirements. As stated above, OMB Circular A-133 requires that the entity engage an outside audit of the financial award. The outside audit is generally either performed by a CPA firm or by a state auditor’s office. Financial assistance awards to commercial entities require governmental audit, which is generally DCAA.

Note: There is a perception that OMB Circular A-133 requirements and Federal regulations prevent additional auditing of financial assistance agreements with educational institutions, other non-profit

entities, and state or local governments. 10 CFR 600 does allow additional audit effort of entities covered by OMB Circular A-133 when the contracting officer deems it necessary. However, under the single audit act, any additional auditing should compliment the OMB Circular A-133 report. There should not be duplicated audit effort in the rare cases when additional audit effort is requested.

Other Areas of Audit Consideration

Fixed Obligation Awards

Fixed obligation awards are financial assistance awards, generally grants, which are similar to fixed-price contracts. In a fixed obligation award, funds are issued in support of a project without a requirement for Federal monitoring of actual costs subsequently incurred. However, under Small Business Innovative Research (SBIR) awards for Phase I, any monies greater than \$500 not expended at the end of the financial assistance term must be returned to the Government.

There are no audit requirements for post-award closeout of fixed obligation awards.

Cost Sharing or Matching

Description

Cost sharing or matching either by cash contribution or in-kind contribution requires that the contractor or recipient contribute to the project through either cash matching (contribute a proportion of total allowable costs) or by in-kind contribution (contributions other than cash). Cost sharing may be dictated by program responsibilities or by statute.

Cost sharing can be found in either contracts or financial assistance awards. However, most current cost sharing is associated with financial assistance awards.

Generally, cost sharing is required when a project's ultimate goal is commercialization and utilization of technology by the private sector when there is reasonable expectation that the recipient will receive significant present or future economic benefit. Particular attention

should be paid to the wording of the cost sharing terminology in the award document (whether contract or financial assistant award).

Audit Responsibilities

Cost Sharing

Cost Sharing requires a determination of total allowable costs (generally by audit) since the majority of cost sharing agreements requires that the cost sharing be a percentage of total allowable costs. Unallowable costs are excluded when determining the Government's share.

The audit requirements for cost sharing agreements are the same as discussed above. The type of audit is again dependent on the type of entity the cost sharing arrangement is with.

In addition to being allowable under the applicable cost principles, 10 CFR 600.123 also requires the following criteria be considered when reviewing a cost sharing agreement:

- Contributions are verifiable from the recipient's records.
- Contributions are not included as contributions for any other Federally assisted project or program.
- Contributions are necessary and reasonable for proper and efficient accomplishment of project or program objectives.
- Contributions are not paid by the Federal Government under another award, except where authorized by Federal statute to be used for cost sharing or matching.
- Contributions are provided for in the approved budget.

Contributions of unrecovered indirect costs may be included as part of cost sharing or matching.

In-Kind Contributions

There is a special challenge when determining the actual value of in-kind contributions. In-kind contributions can be donated equipment, property, supplies, donated services, volunteer services, or any other “valuable” that is agreed upon in the award instrument. In addition to the criteria listed above, 10 CFR 600.123 also requires:

- Real property or buildings for construction/facility acquisition projects or long-term use shall be the lesser of the certified value of the remaining life of the property recorded in the recipient’s accounting records at the time of donation or the current fair market value. DOE can authorize the use of current fair market value when it exceeds cost when there is sufficient justification.
- The value for volunteer services shall be consistent with those paid for similar work in the recipient’s organization or in the labor market in which the recipient competes. Reasonable, allowable, and allocable **paid** fringe benefits may be included in the valuation.
- Services furnished by others (non-recipient) shall be valued at the employee’s regular rate of pay (plus fringe benefits that are reasonable, allowable, and allocable, but **exclusive of overhead costs**) for the same skill for which the employee is normally paid.
- Donated supplies shall be reasonable and shall not exceed the fair market value at the time of the donation.
- The valuation of donated equipment, buildings, and land where title passes to the recipient is dependent on the purpose of the award.
 - If the purpose is to assist the recipient in the acquisition, the total value of the donated property may be claimed as cost sharing or matching.
 - If the purpose is to support activities that require the **use** of the property, only depreciation or a use charge may be

made unless DOE has given specific approval for the use of the full value.

- The value of donated property shall be determined in accordance with the usual accounting policies of the recipient. However, the value of donated land and buildings shall not exceed its fair market value at the time of the donation to the recipient as established by an independent appraiser and certified by a responsible official of the recipient.
- The value of donated equipment shall not exceed the fair market value of equipment of the same age and condition at the time of donation.
- The value of donated space shall not exceed the fair rental value of comparable space as established by an independent appraisal of comparable space and facilities in a privately owned building in the same locality.
- The value of loaned equipment shall not exceed its fair rental value.

The supporting records for contributions from third parties require that volunteer services be documented in the same method used by the recipient for its own employees and the basis for determining the method of valuation is documented.

Self-Test - Questions

1. The audit cycle covers the _____ FY and includes the submittal, audit, and negotiation of the awardees _____.
2. Name some of the factors that should be considered when trying to determine whether to request a site audit or perform a desk review:
 - a) _____
 - b) _____
 - c) _____
 - d) _____
 - e) _____
3. The difference between a time and material contract and a labor hour contract is the inclusion and allowability of _____.
4. The difference between the various cost contracts is the presence or absence of _____.
5. The post award auditing of fixed-price contracts is limited to _____ or _____.
6. The two major factors which determine whether an award is a contract, grant, or cooperative agreement are _____ and _____.
7. True or False--A fixed obligation award requires a grantee to follow the applicable cost principles and return unspent money.
8. True or False--Cost sharing or in-kind contributions are computed on total costs.

9. True or False--In-kind contributions requires the Government to review and validate the value of the in-kind contribution.
10. True or False—When performing a desk review, in lieu of a DCAA audit, it is crucial that the indirect rate proposal submitted by the contractor is reconciled to their Federal tax return, audited financial statements, or general ledger?

Self-Test - Answers

1. The audit cycle covers the **awardee's** FY and includes the submittal, audit, and negotiation of the awardees **final indirect rate proposal**.
2. Name some of the factors that should be considered when trying to determine whether to request a site audit or perform a desk review:
 - a) **Prior audit history of the entity.**
 - b) **The size of the award.**
 - c) **Whether or not the entity has other Federal awards.**
 - d) **The timing of the audit cycle.**
 - e) **Cost benefit of obtaining an outside audit.**
3. The difference between a time and material contract and a labor hour contract is the inclusion and allowability of **materials**.
4. The difference between the various cost contracts is the presence or absence of **fee**.
5. The post award auditing of fixed-price contracts is limited to **changes** or **effective pricing**.
6. The two major factors which determine whether an award is a contract, grant, or cooperative agreement are **who benefits** and **the level of Government participation and involvement**.
7. True or False--A fixed obligation award does not require a grantee to follow the applicable cost principles, but does require the return of unspent money if greater than \$500. **False**
8. True or False--Cost sharing or in-kind contributions are computed on total Allowable costs. **False**
9. True or False--In-kind contributions require the Government to review and validate the value of the in-kind contribution. **True**
10. True or False—When performing a desk review, in lieu of a DCAA audit, it is crucial that the indirect rate proposal submitted by the contractor is

reconciled to their Federal tax return, audited financial statements, or general ledger? **True. It is imperative that this step be performed early during the desk review to ensure costs claimed represent actual costs incurred by the entity. This can be one of the more difficult tasks in the desk review process.**

Module 2

Cost Principles

Objectives

Upon completion of this module, you should be able to do the following:

- Identify the following different cost principles that are applicable:
 - ✓ Commercial Entities
 - ✓ Non-Profit Entities
 - ✓ Educational Institutions
 - ✓ State and Local Governments
- Understand unallowable costs.

Estimated Completion Time

2 hours

Introduction

The cost principles that apply to a Federal award depend upon the type of entity involved. These same cost principles will apply to that entity irrespective of whether the entity receives a contract or a financial assistance award.

The cost principles are primarily used in the determination of allowable costs. The principles stipulate the types of costs that are expressly unallowable and discuss allocability and the reasonableness of costs charged to the award.

The cost principles applicable to commercial organizations and non-profit organizations will most likely be the ones that you should become familiar with first since the majority of Federal awards are to these entities. The cost principles for commercial entities are contained in Federal Acquisition Regulations (FAR) 31. Each set of cost principles is tailored for the specific entity. For example, educational institutions incur stipends and typically provide in-kind or donated services. Office of Management and Budget (OMB) Circular A-21, which contains the cost principles applicable to these entities, therefore, specifically addresses stipends and in-kind contributions.

In recent years, efforts have been underway to make all the cost principles more uniform. For example, both the FAR and OMB Circulars have been modified and updated to make the cost principles more uniform.

Cost Principles

Commercial Entities

FAR, Subpart 31.2 establishes cost principles for all commercial entities under cost reimbursement contracts, changes to fixed-price contracts, and financial assistance awards. A company's failure to comply with these cost principles would obviously result in the disallowance of costs, but could also result in administrative and criminal penalties. The FAR is available at several different web sites. A common one maintained by GSA on behalf of DOE, Department of Defense (DOD), and National Aeronautics and Space Administration is located at

<http://www.arnet.gov/far/>. The DCAA Contract Audit Manual provides a useful guide for interpreting the more complicated cost principles contained in FAR Subpart 31.2. This manual is updated in January and July of each year. The manual is available to the general public for a nominal annual subscription by writing to the following address:

Superintendent of Documents
Post Office Box 371954
Pittsburgh, Pennsylvania 15250-7954

Although the established cost principles should suffice in most contractual situations, under special circumstances it may be beneficial for the Government to enter into an advance agreement with the contractor for particular types of costs. When doing so, FAR 31.109 advises:

“Advance agreements may be negotiated either before or during a contract but should be negotiated before incurrence of the costs involved. The agreements must be in writing, executed by both parties, and incorporated into applicable current and future contracts. An advance agreement shall contain a statement of its applicability and duration.”

An advance agreement, if negotiated successfully, can make an otherwise allowable cost unallowable under a contract due to special circumstances. These costs then become “unbillable.” Alternatively, an expressly unallowable cost can never be made allowable under a contract even with an advance agreement, unless a “deviation” is obtained from HQ.

Non-Profit Entities

OMB Circular A-122 provides the cost principles for determining allowable costs under contracts, financial assistance, and other types of awards with non-profit entities. Circular A-122 contains a listing of expressly unallowable costs. These costs are to be considered

unallowable regardless of whether they are classified as direct or indirect.

For indirect costs, unless different arrangements are agreed to by the agencies concerned, the Federal agency with the largest dollar value of awards with a non-profit entity will be designated as the cognizant agency for the negotiation and approval of indirect rates. Non-profit entities are required to submit an indirect cost proposal to their cognizant agency within 6 months after each of their fiscal year end (FYE). These proposals provide the basis for the review and negotiation of indirect cost rates. The results of each negotiation should be formalized in a written agreement between the cognizant agency and the non-profit entity. The cognizant agency will then distribute copies of the rate agreement to all other agencies that have awards with the non-profit entity.

All OMB Circulars are available from the White House web site located at <http://www1.whitehouse.gov/WH/EOP/OMB/html/circular.html>.

Educational Institutions

OMB Circular A-21 contains the cost principles for determining allowable costs under contracts, financial assistance, and other types of awards with educational institutions. Circular A-21 includes a listing of costs considered unallowable and information concerning why these costs are expressly unallowable.

For indirect costs, the DHHS is the CFA responsible for negotiating and approving indirect rates with most educational institutions on behalf of all other Federal agencies. In general, the negotiated rates must be accepted by the other Federal agencies. Only under special circumstances, such as when required by law or regulation, may an agency use a rate different from the negotiated rate.

Public Law 87-638 authorizes the use of predetermined rates with educational institutions. Predetermined rates are indirect rates negotiated between the cognizant agency and the institution well in advance of the FY they pertain to and they may cover multiple years. Reimbursement of allowable indirect costs is made under contracts and financial assistance awards using these rates with no subsequent

adjustments. The stated objectives of the law authorizing the use of predetermined rates are to simplify the administration of cost-type contracts and financial assistance awards and to permit more expeditious closeout.

A major difference between the cost principals in OMB Circular A-21 and cost principles for other entities is the treatment of Facilities and Administration (F&A) costs. Such costs, as defined in the Circular, are limited to 26 percent of the modified total direct cost allocation base. The CFA is responsible for negotiating this limitation, which only applies to the F&A cost pool. The educational institution may have other cost pools that result in an overall rate higher than 26 percent, but the F&A portion must fall within the limitation.

State and Local Governments

OMB Circular A-87 contains the cost principles for determining allowable costs under contracts, financial assistance, and any other types of awards with state and local governments, including Federally recognized Indian Tribal Governments. The principles and standards in OMB Circular A-87 provide a uniform approach in determining the allowability and allocability of costs for state and local governments.

OMB Circular A-87 is similar to OMB Circular A-21 in that it lists and discusses costs that are expressly unallowable and provides for a CFA responsible for negotiating and approving indirect rates on behalf of all other Federal agencies. Predetermined rates are also widely used with state and local governments.

One difference between OMB Circulars A-87 and A-21 is that the F&A cost limitation is not included in OMB Circular A-87. Additionally, OMB Circular A-87 requires state and local governments to submit a cost allocation plan to the DHHS for approval. These cost allocation plans stipulate how indirect costs will be claimed and billed under Federal awards.

Cost Principle Highlights

Senior Executive Compensation

A significant change to the FAR cost principles made recently is the limitation on contractor senior executive compensation. The term “senior executives” is currently defined in FAR 205-6(p) as the five most highly compensated employees in management positions for the contractor at their home office and at each business segment. The current maximum salary cap is \$342,986 per annum effective January 1, 1999, and thereafter. The current definition of what constitutes “senior executives” and the amount of the salary cap have changed from earlier years. This cost principle is fairly new so additional changes in its implementation can be expected.

DOE’s latest implementation guidance is contained in Acquisition Letter (AL) 99-02, dated March 11, 1999. This AL also contains advance approval requirements unique to DOE. The AL’s are available at <http://www.pr.doe.gov/acqltr.html>.

Indirect Rate Certification and Penalties

FAR 31.110, “Indirect cost rate certification and penalties on unallowable costs,” was recently changed to allow the Government to assess penalties and interest against the contractor if unallowable costs are contained in certified indirect cost rate proposals. FAR 42.709 specifies the administrative procedures regarding the penalty assessment. Contracts in excess of \$500,000, except fixed-price contracts, are subject to this penalty.

Patent Costs

FAR 31.205-30, 31.205-33 and 31.205-37 address the allowability of patent costs. Patent costs are generally costed through the entity's indirect rates since they "benefit" the entity as a whole. Patent costs such as those associated with preparing invention disclosures, reports and other documents, or providing general patent counseling services, are allowable. Other costs, such as those associated with filing and prosecuting patent applications, are unallowable unless they are incurred as a requirement of the contract and title or a royalty-free license is conveyed to the Government. Contracts having a need to file and prosecute patent applications are extremely rare. If costs associated with

filing and prosecuting patent applications are found, these costs should be examined in detail to determine whether they are allowable under the contract.

When significant patent costs are encountered during the review, the organization's intellectual property counsel (or patent counsel) office should be consulted. Patent costs involve such a technical area that it is almost impossible for the reviewer to determine allowability without input from technically qualified individuals. The allowability of patent costs is determined on a contract by contract basis. Also, the allowability of patent costs is determined by whether patenting of inventions made under the contract is a requirement of an individual contract and the Government has rights in the subject invention for which costs are being charged. Therefore, it may be necessary to "revise" indirect rates established by the CFA if the entity has significant patent costs that are unallowable in the awards administered by your office.

Travel Costs

The GSA recently issued new per diem rates that exclude lodging taxes. Lodging taxes are now claimed as miscellaneous costs. FAR 31.205-46 requires contractors to stay within the per diem rates established by GSA (the DOD has obtained a class deviation, effective through September 30, 1999, or until FAR 31.205-46(a)(2) is revised). This class deviation may affect the allowability of travel costs to DOE contracts. Therefore, during a review of travel costs, it is important to know whether the contractor accounted for travel in accordance with the revised GSA per diem rates or in accordance with the DOD deviation.

It is necessary to keep current on this issue since it appears that DOD is trying to get GSA to revert back to their old way of establishing per diem or removing the per diem limit from contractors. DOD's position is that the defense contractors may "encounter a significant administrative burden and incur substantial costs in modifying their systems to comply with this new rule."

Retirement Costs

DOE has many support service contracts with small businesses. These small businesses will open offices close to the DOE and maintain a staff

for the duration of the contract, which usually runs from 3 to 5 years. Generally, these small businesses have 401K type retirement systems for their employees.

Even though not addressed in the FAR, when reviewing retirement costs the reviewer should ensure that the amount reimbursed by the Government does not result in a windfall for the contractor. A determination should be made as to when the employees “vests” in the retirement system. Note that, upon an employee’s termination or contract end date, the Government’s contribution should either go with the employee (“vested”) or be returned (not “vested”).

In a previous case where the contractor closed its site office and terminated the employees after contract expiration, the Internal Revenue Service ruled that the “vesting” of an employee occurs either on the vesting anniversary date or the date of Government contract expiration when termination occurs, whichever comes first.

Training Resources

Several cost principle resources are available to assist you in reviewing the allowability of costs. The DCAA provides training for its reviewers and has available several self-study courses. One specific self-study course of value to anyone reviewing the allowability of costs is entitled “Audit Applications of FAR Part 31 Cost Principles”. You can obtain a copy of the DCAA’s “Catalog of Training Courses” (DCAAP 1421.3) by writing to the Defense Contract Audit Institute at the following address:

Defense Contract Audit Institute
Memphis, Tennessee
Sandra Davidson, Training Coordinator
(901) 325-6383

Self-Test - Questions

1. True or False--The cost principles that will apply to a contractor depend on what type of contract is being awarded.
2. True or False--There are no cost principles for non-profit entities.
3. True or False--A DOE contracting officer can establish an advance agreement that is unique to a contract for a particular type of cost.
4. Name the OMB Circular that establishes cost principles for educational institutions and the OMB Circular that is applicable to governmental entities.
5. True or False--There are no limitations on the salary levels of DOE contractors?

Self-Test - Answers

1. True or False--The cost principles that will apply to a contractor depend on what type of contract is being awarded. **False. The cost principles that will apply depend on the type of entity (commercial, non-profit, educational, or governmental).**
2. True or False--There are no cost principles for non-profit entities. **False. OMB Circular A-122 provides the cost principles for not-for-profit entities.**
3. True or False--A DOE contracting officer can establish an advance agreement that is unique to a contract for a particular type of cost. **True. Although the cost principles contained in FAR 31.2 should suffice in most contractual situations, it may be beneficial for the Government to enter into an advance agreement with the contractor for particular types of costs (FAR 31.109).**
4. Name the OMB Circular that establishes cost principles for educational institutions and the OMB Circular that is applicable to governmental entities. **OMB Circular A-21 is for educational institutions and OMB Circular A-87 is for governmental entities.**
5. True or False--There are no limitations on the salary levels of DOE contractors? **False. Beginning in FY 1997, there is a salary cap on senior executives of DOE contractors. The most recent DOE Acquisition Letter on this subject should be referred to when contractor executive compensation is at issue.**

Module 3

Indirect Rates

Objectives

Upon completion of this module, you should be able to understand the following:

- Indirect rates and how they are calculated.
- The components of indirect rates.
- The audit responsibility.
- The negotiation process and cognizant agency responsibility.

Estimated Completion Time

2 hours

Introduction

Indirect rates are one of the most difficult concepts to understand. New contractors do not understand them, many contracting officers and technical people do not understand them, CPA's who have never worked on Government contracts do not understand them, and most financial people new to the Government do not understand them.

Indirect costs comprise approximately 50 percent of an award's costs, they account for most of the questioned costs, and they hold up the closeout process. The negotiation of final indirect costs is a requirement of every cost type contract, grant, and cooperative agreement with every type of entity (commercial, non-profit, educational, or a state or local government).

Once you understand the rationale behind why indirect rates are necessary, it becomes clear why indirect costs under Government awards are calculated as they are.

First is the concept of "cost" type award (which includes financial assistance). The Government, under a cost type award, will pay their "fair share" of total "allowable," "reasonable," and "allocable" costs. Indirect costs have to be allowable under the appropriate cost principles, they have to be reasonable, and they must be allocable. Allowable and reasonable are discussed in other modules to this study guide. This module centers around understanding allocable.

Costs directly incurred specifically for a Government award benefit only that award and represent the Government's "fair share." Costs that cannot be directly attributed to a specific project (without being "allocated") are considered "indirect costs." The issue becomes how much is the Government's "fair share." Thus the concept of calculating an "indirect rate." The indirect rate is used to "allocate" the indirect costs to specific final cost objectives (i.e. projects whether commercial or Government). If the indirect cost is computed properly and if an appropriate "base" is used for allocation, then the Government is ensured that it is only reimbursing its "fair share" of costs.

Definition

An indirect cost is any cost not directly identified with a single, final cost objective, but rather identified with two or more final cost objectives or an intermediate cost objective.

After direct costs have been determined and charged directly to the project, indirect costs are those remaining to be allocated to the several cost objectives. A direct cost is described in the FAR (FAR 31.202) as:

A direct cost is any cost that can be identified specifically with a particular final cost objective. No final cost objective shall have allocated to it as a direct cost any cost, if other costs incurred for the same purpose in like circumstances have been included in any indirect cost pool to be allocated to that or any other final cost objective. Costs identified specifically with the contract are direct costs of the contract and are to be charged directly to the contract. All costs specifically identified with other final cost objectives of the contractor are direct costs of those cost objectives and are not to be charged to the contract directly or indirectly.

For reasons of practicality, any direct cost of minor dollar amount may be treated as an indirect cost if the accounting treatment—

- (1) is consistently applied to all final cost objectives; and*
- (2) produces substantially the same results as treating the cost as a direct cost.*

An indirect cost is described in the FAR as:

An indirect cost is any cost not directly identified with a single, final cost objective, but identified with two or more final cost objectives or an intermediate cost objective. It is not subject to treatment as a direct cost. After direct costs have been determined and charged directly to the contract or other work, indirect costs are those remaining to be allocated to the several cost objectives. An indirect cost shall not be allocated to a final cost objective if other costs incurred for the same purpose in like circumstances have been included as a direct cost of that or any other final cost objective.

Indirect Pools

The pool represents the logical grouping of indirect costs remaining to be distributed.

Pool Costs

The pool costs are the indirect costs remaining after all direct costs have been charged to the appropriate final cost objectives.

Base Costs

The base is an allocation group that in some way relates logically to the pool groupings. The FAR defines the “base” as:

Indirect costs shall be accumulated by logical cost groupings with due consideration of the reasons for incurring such costs. Each grouping should be determined so as to permit distribution of the grouping on the basis of the benefits accruing to the several cost objectives. Commonly, manufacturing overhead, selling expenses, and general and administrative (G&A) expenses are separately grouped.

Similarly, the particular case may require subdivision of these groupings, e.g., building occupancy costs might be separable from those of personnel administration within the manufacturing overhead group. This necessitates selecting a distribution base common to all cost objectives to which the grouping is to be allocated. The base should be selected so as to permit allocation of the grouping on the basis of the benefits accruing to the several cost objectives.... Once an appropriate base for distributing indirect costs has been accepted, it shall not be fragmented by removing individual elements.

All items properly includable in an indirect cost base should bear a pro rata share of indirect costs irrespective of their acceptance as Government contract costs.... The contractor's method of allocating indirect costs shall be in accordance with standards promulgated by the CAS Board, if applicable to the contract; otherwise, the method shall be in accordance with generally accepted accounting principles which are consistently applied.

It is important to understand the entity being reviewed to ensure that the allocation base is logical and shows a casual/beneficial relationship between the indirect cost and the allocation base. Most small businesses will have anywhere from one to three rates (overhead, G&A, or fringe benefits). Larger entities may have anywhere from three to hundreds of indirect cost pools and bases, depending on the size and complexity of the entity. However, in all cases, there should be some casual/beneficial relationship between the indirect pool and the base utilized to allocate the pool.

Indirect Rate

The indirect rate is a simple mathematical calculation. The pool costs are divided by the base costs to derive the indirect rate. The indirect rate is then “applied” to the individual final cost objective’s base. This results in the appropriate indirect costs allocable to each final cost objective.

Components

It is important to understand that what is a direct cost to one entity may be considered indirect to another entity. How an entity establishes their indirect allocation method is outside the Government’s responsibility. The allocation method must be consistently applied within the entity and the base chosen to allocate indirect costs must demonstrate a casual/beneficial relationship and results in a fair allocation of indirect costs. It is for this reason that it is almost impossible to “compare” indirect rates across entities without reviewing how each entity’s indirect rate structure is established. It is like comparing apples to oranges.

As an example, most Architecture and Engineering (A&E) firms tend to have high indirect costs. Why? Because most A&E’s only consider labor as direct. Almost every other cost is considered indirect. However, there are some A&E firms that have a very low indirect rate because almost every cost is charged direct. They have placed their resources in technology. If you want to make a phone call, you must “punch in” the project number the call relates to. If you want to make a copy of something, you must identify the project that the copy relates to.

Therefore, is it better to contract with this entity over another A&E because their rates are lower than the other? The answer is NO or not necessarily since this entity’s direct costs and total costs may be higher than the total costs of other A&E’s.

The point is to not get “wrapped-up” in comparing indirect rates among entities. Since each entity is unique, a low or high indirect rate does not necessarily mean more expensive or less expensive. It does not necessarily mean more cost conscious or efficient or less cost conscious or efficient. What it means is difference...each entity has established an indirect rate structure unique to its corporate philosophy. It is this

difference which explains why one entity may have one rate, and another similar size entity may have three rates.

Indirect Rate Components

Although every organization has its own rate structure, we will discuss the most common indirect cost pools below:

Indirect Pools

Fringe Benefits

Fringe benefits generally represent indirect costs that are attributable to individual employees. Fringes are generally the employer's portions of payroll taxes, insurance, and retirement plans. Since fringe benefits relate to the employee, the base is generally total labor dollars or total labor hours (dollars is the most widely used).

Overhead

Many times overhead and fringe benefits are combined into one rate. Overhead generally relates to "division" or "department" type indirect costs. Indirect costs such as the division director's salary, secretarial salaries, indirect travel, etc. comprise the overhead department costs. In a service type department which is labor intensive, the general overhead base is either direct labor dollars or direct labor hours (dollars is the most widely used). In a manufacturing overhead which is not labor intensive, the base could be total direct costs or square feet, or number of pieces manufactured, etc.

General and Administrative

G&A generally represent indirect costs that are attributable to the overall entity. Costs such as corporate officer's salaries, corporate secretaries, facility costs, general legal fees, etc. are considered G&A costs. Since G&A is a corporate wide pool, it **must**, per the FAR, be allocated on either a total cost input or value added base.

The above pools represent the majority of indirect pools that will be encountered. Larger organizations may also have material handling or subcontract administration pools.

Allocation Bases

Commercial Entities

Most allocation bases with commercial entities are the ones identified above, direct labor dollars or hours, total labor dollars or hours, or total cost input or value added. As previously discussed, as long as there is a casual/beneficial relationship between the pool and the base that results in a fair allocation of costs, the Government should accept the entity's method of allocation.

However, a note of caution is advised. Generally, small businesses have labor as their allocation base. This method is generally acceptable when the business is still small or doing their predominate business with the Government. It is important that the mixture between Government and commercial work be closely monitored. Once a small business begins to grow and get a different mix of work (Government versus commercial and cost type work versus fixed-price work), it becomes more critical that the allocation base be equitable. The majority of small businesses is forced to adopt a total cost input base as they begin to grow since a direct labor base allocates costs more inequitable as the mix of work becomes more pronounced.

Furthermore, there are certain costs that must, by the FAR, be allocated over either a total cost input base or value added base. Independent Research and Development and Bid and Proposal Costs must be allocated over the total entity since these costs benefit the entity as a whole.

Educational Institutions and Other Non-Profit Entities

The OMB Circular A-122 requires that educational institutions and other non-profit entities allocate their indirect costs over a “modified total direct cost input base” (MTDC). Generally, the MTDC consists of total costs excluding certain costs such as equipment, subcontracts costs over \$25,000, and “pass-through” costs.

The predominant reason that equipment and a portion of subcontract costs and other such costs are excluded from the base relates back to the casual/beneficial relationship.

State of Local Governments

Most state or local governments allocate their indirect costs on either total costs or a MTDC base.

Audit

FAR 42.705 contains the information concerning the audit and negotiation of final indirect rate submissions. Some type of audit is required of an entities final indirect cost submission. The audit ensures:

- the entities indirect cost allocation methods are logical and result in a fair allocation of indirect costs;
- the entities indirect cost allocation method is consistently applied; and
- all known unallowable costs have been removed.

All final indirect cost submissions must be certified per FAR42.703-2. The certification basically states that all known unallowable costs have been removed from the submission and no unallowable costs have been charged to the Government. Final indirect cost submissions should not be accepted unless they have been properly certified and no agreements for billing or final rates should be made unless the submissions have been certified. Furthermore, FAR 42.703 and FAR 31.110 require that penalties be assessed for contractors who falsely certify or include known unallowable costs in their submissions. FAR 42.709 provides the information for calculating the penalties.

Note: All entities are required to submit final indirect cost submissions. However, state and local governments and educational institutions generally have a “CFA” responsible for negotiation of yearly indirect rates. You will generally not have to perform negotiation or audit of these entities. Commercial entities and non-profit entities are the predominate entities which will require you to obtain the final indirect submission and either request a site audit (from DCAA) or perform a desk review.

Care should be taken when reviewing the OMB Circular A-133 audit reports relating to other non-profit entities. Most OMB Circulars A-133

audits do not review or establish the final indirect rates. Generally, you will need to request the grantee (or contractor) to provide a certified submission. Once received, a desk review will generally suffice to establish and audit the indirect rate.

Indirect submissions are due 6 months after the expiration of the contractor (or awardee) FY. Most of the audit backlog is due to the entities not providing their submissions on a timely basis. Indirect submissions should be sent to either the contracting officer or the cognizant audit agency (generally DCAA).

Negotiation Responsibility

The responsibility for negotiation of indirect rates for all the Federal Government rests with the CFA. FAR 42.703-1 provides the requirement for establishing a single responsible agency for negotiation of indirect rates. The CFA is generally the agency that has the preponderance of work. When DOE is not the CFA, the Department will accept and use the indirect cost rates established for the respective organization by the CFA or another Federal agency, provided any required adjustments are made to reflect DOE-specific cost principles or contractual advanced agreements.

When the DOE is the CFA, then the designated Cognizant DOE Office (CDO) is responsible for negotiation of the indirect rates **for all the Government**.

A listing of cognizant agencies for state and local governments and educational institutions is listed in OMB Circular A-88. Educational Institution CFA's is generally either the DHHS or the Office of Naval Research.

DOD 4105.59-H "Directory of Contract Administration Services Components" lists the CFA for major defense contractors.

Self-Test - Questions

Awards	Labor	ODC	Total	Fringe	G&A
Government - Cost Type					
1	100	25	125		
2	50	10	60		
3	75	15	90		
Commercial and fixed price	500	60	560		
	725	110	835		

Fringe	Pool	G&A	Pool
Payroll Tax	25	Indirect Labor	175
Benefits	150	Fringe	34
Total Pool	175	Facility	650
		Utility	25
		Total	884
	Base		
Direct Labor	725	Total Cost	Base
Indirect Labor	175	Total Direct	835
	900	Total Fringe	141
		Total	976
Fringe Rate	19.4%	G&A Rate	90.6%

1. How much fringe benefits and G&A should be allocated to each of the above awards?
2. True or False--An indirect cost is any cost directly identified with a single, final cost objective.
3. True or False--A base is defined as a logical cost grouping which is determined based on the benefits accruing to the several cost objectives.

4. True or False--It is the Government's responsibility to ensure that a company adopts an indirect rate structure that allocates indirect costs on a fair and equitable basis.
5. True or False--OMB Circular A-133 audit requirements apply to educational, non-profit, and commercial entities.

Self-Test - Answers

- How much fringe benefits and G&A should be allocated to each of the below awards? **Fringe benefits - \$141 and G&A - \$884**

Awards	Labor	ODC	Total	Fringe	G&A
Government - Cost Type					
1	100	25	125	19	130
2	50	10	60	10	63
3	75	15	90	15	95
Commercial and fixed price	500	60	560	97	595
	725	110	835	141	884

Fringe	Pool
Payroll Tax	25
Benefits	150
Total Pool	175

G&A	Pool
Indirect Labor	175
Fringe	34
Facility	650
Utility	25
Total	884

	Base
Direct Labor	725
Indirect Labor	175
	900

Total Cost	Base
Total Direct	835
Total Fringe	141
Total	976

Fringe Rate	19.4%
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- True or False--An indirect cost is any cost directly identified with a single, final cost objective. **False. An indirect cost is any cost identified with two or more final cost objectives.**
- True or False--A base is defined as a logical cost grouping which is determined based on the benefits accruing to the several cost objectives. **True and False. Both the pool costs and the base costs are logical groupings which the pool costs should be distributed over a base that relates logically and with casual/beneficial relationship to the pool.**

4. True or False--It is the Government's responsibility to ensure that a company adopts an indirect rate structure that allocates indirect costs on a fair and equitable basis. **False. It is not the Government's responsibility to ensure that a company adopts an equitable indirect rate structure. We should not be dictating how indirect costs are allocated. It is, however, the Government's responsibility to ensure that the method adopted by an entity results in a fair and equitable allocation to Government contracts.**
5. True or False--OMB Circular A-133 audit requirements apply to educational, non-profit, and commercial entities. **False. OMB Circular A-133 audit requirements apply to educational and non-profit institutions and state or local governments.**

Module 4

Closeout

Objectives

Upon completion of this module, you should be able to do the following things:

- Explain the process for conducting closeouts on cost reimbursement types contracts from a financial standpoint.
- Provide a definition of quick-closeout and identify FAR requirements regarding its use.
- Discuss the process for closing out financial assistance awards.

Estimated Completion Time

3 hours

Contract Closeout

Background

Chapter 21 of the DOE Accounting Handbook provides the financial policy for the closeout of contracts. The DOE policy is to closeout contractual instruments in a timely manner following their physical completion. This policy states the contracting officer has principal responsibility for initiating, coordinating, and certifying closeout. The field CFO Organization is responsible for the financial settlement.

Definition

A cost reimbursement type contract, although physically complete, is not closed until all administrative and financial actions have been completed. From a financial standpoint, all indirect rate adjustments must be made based on final negotiated rates, any disputes settled, final payment including fee retainage paid, and a final release of claims against the Government arising out of the contract has been signed by an officer of the contractor. From a financial management standpoint, closeout involves settling all financial and accounting matters between the contractor and DOE.

Requirements

FAR 4.804-5, "Detailed Procedures for Closing Out Contract Files," states the following:

The office administering the contract is responsible for initiating administrative closeout of the contract after receiving evidence of its physical completion.

This clause also states that the administrative closeout procedures shall ensure:

- all interim or disallowed costs are settled;
- prior year indirect cost rates are settled;
- contract audit is completed;

- contractor's closing statement is completed;
- contractor's final invoice has been submitted; and
- contract funds review is completed and deobligation of any excess funds is recommended.

FAR 4.804-1, states, “contracts requiring settlement of indirect cost rates should be closed within 36 months of the month in which the contracting officer receives evidence of physical completion.” This time requirement is not widely adhered to by Federal agencies. With cost reimbursement type contracts, the process can take longer than 36 months. Coordination among the contracting office, the CFO organization, the CFA for the contractor, and DCAA helps expedite the process.

Chapter 21 of the DOE Accounting Handbook requires:

- verification and mutual agreement as to costs incurred and payments to the contractor;
- confirmation, establishment, and collection of any credits owed to DOE;
- verification of amounts obligated; and
- verification of final payment to the contractor.

The implications of these requirements are that CFO organizations need to verify contract documents and payments to the Departmental Integrated Standardized Core Accounting System (DISCAS) and aid the contracting officer in arriving at a mutually agreed upon final amount of allowable costs with the contractor at the time of closeout.

Contract Closeout Process

As explained in Module 1, the necessary actions that must be taken during the course of the contract to aid in its eventual closeout include:

- Requesting DCAA incurred cost audits when the contract is awarded.
- Most importantly, ensuring indirect cost submissions are submitted to the contracting officer and to DCAA by the contractor at the end of their FY.
- Negotiating final indirect rates using the audits on the submissions.
- Obtaining and reviewing indirect cost adjustment vouchers based on the final indirect rates.

From a financial standpoint, the closeout process typically begins with the receipt of the contractor's summary settlement statement and final voucher. The summary settlement statement is a broad compilation of cumulative direct and indirect costs incurred and the amount of fixed fee. The final voucher is the contractor's absolute final claim for cost or fee under the contract. There will be no more vouchers after this one.

If the indirect rate administration process during the course of the contract took place correctly, the final voucher would be zero or it would only be for fee retainage. Often this is not the case, and there are pending adjustments at the time of closeout that need to be verified. The following is a process for use on contract closeouts.

Prepare an Analysis of the Contract

The contract and all modifications need to be analyzed to identify the type of contract, period of performance, total estimated costs, and amount of fixed fee. A running tally of individual obligations from the contract and modifications should be made for confirmation of cumulative obligations as shown in DISCAS. This will provide the needed verification of cumulative obligations between the actual contract document and DISCAS.

More importantly, the contract and its modifications may contain advanced understandings regarding costs that must be identified and considered before final closure. It is also recommended that the contract correspondence files be reviewed to identify any contracting officer decisions or any “notice of intent to disallow costs” that were issued.

Prepare a Voucher Schedule

During the course of a contract, the contractor submits vouchers monthly for reimbursement of costs. A voucher schedule at the closeout stage is a recap of total costs billed and paid under the contract using any spreadsheet application. Total payments made under the contract are scheduled out by cost element (direct labor, overhead, G&A, etc.) and is subtotaled by the contractor’s FY. The voucher schedule is by the contractor’s FY, because this is the period of time that indirect rate adjustments are based on. A grand total of all payments should be calculated and confirmed with total payments as shown in DISCAS. Since the voucher schedule will be instrumental in calculating the final adjustment under the contract, it must agree with DISCAS.

When scheduling the vouchers, it is important to keep track of any cost disallowances that were made during the course of the contract because these will likely not be accounted for properly when the incurred cost submissions are later prepared by the contractor. For example, a contracting officer may disallow unapproved labor or travel costs and deduct this from a monthly voucher. These costs will likely continue to be included in the contractor’s books and records as an allowable cost attributable to the contract and included as such in the incurred cost submission. The DCAA reviewers, unaware that these normally allowable costs were deducted from the monthly vouchers, will not question them and include the costs in their total allowable cost by contract schedule contained in their audit report. Any previously disallowed costs will have to be backed out from the DCAA schedule to arrive at the final amount of allowable costs incurred reimbursable under the contract.

Voucher schedules are used to compare costs billed at provisional indirect rates with allowable costs for each of the contractor’s FY as disclosed in the DCAA audit reports. This comparison will also show

which cost categories the adjustments are being claimed (in direct labor, overhead, G&A, etc.). Although adjustments in indirect cost categories should be expected, inquiries to the DCAA reviewers or to the contractor should be made if there are significant adjustments in the direct cost categories.

Prepare a Closing Statement

A closing statement should be prepared which brings together the voucher schedule and the audit results from the DCAA incurred costs audits. The voucher schedule shows what has already been paid under the contract. The audit report has a schedule of allowable costs by contract. The closing statement compares these two amounts for each of the contractor's FY and takes into consideration any advanced understandings in the contract and any previous disallowances that were made from the contractor's monthly vouchers. The closing statement should show what the final cost adjustments are for each year and provide the total amount of allowable fixed fee.

The final cost adjustments and the amount of fee must be mutually agreed to by the contracting officer and the contractor. Closing statements facilitates this process greatly.

When the final amount of cost and fee incurred is determined, it cannot exceed total estimated costs and fixed fee stated in the contract. The limitation of funds clause contained in the contracts precludes reimbursement in excess of these stated amounts. However, the contracting officer, through negotiation and modification to the contract, may increase the total estimated costs stated in the contract to allow a cost overrun in deserving circumstances.

In addition to performing the annual incurred cost audits, DCAA also performs a "final audit" upon request. This is basically just preparing a closing statement using the annual incurred cost audits, and no site visit is even made to the contractor's location. Requesting DCAA to perform this is not an efficient use of audit resources and should only be done in extremely complicated closeouts. Also, when DCAA is asked to prepare the closing statement, they may not be aware of any advance agreements in the contract or any previous disallowances that were made.

Level of Effort Clauses

An important contract provision that may be in some contracts is the level of effort clause. This clause could impact the final reimbursement to the contractor at closeout. This clause is not based on the FAR. It was developed within DOE and is often used when acquiring services.

Contracts containing this clause include an estimated amount of hours that will be needed, referred to as Direct Productive Labor Hours (DPLH). The level of effort clause is then typically worded as follows:

“The fixed fee of this contract is based upon the contractor furnishing the estimated DPLH set forth herein. In the event the contractor is required to provide less than 90 percent of the estimated DPLH, the fixed fee of this contract shall be reduced as mutually agreed upon by the parties.”

Additionally, this clause states that if the contractor is required to provide more than 110 percent of the estimated DPLH, the fixed fee shall be negotiated upward. This clause applies if the actual amount of DPLH provided is less than 90 percent or greater than 110 percent. In this case, the contracting officer will be required to renegotiate the fixed fee prior to closeout of the contract.

When the level of effort clause applies, the 90 to 110 percent test should be applied early in the closeout process because the contracting officer must renegotiate the fixed fee, and the results could have an impact on the final financial settlement. The actual amount of DPLH provided is included in the contractor’s monthly vouchers. The DPLH and associated costs should be entered on the voucher schedule.

Task Order Type Contracts

Task order contracts are similar to delivery order contracts in that individual orders for services are placed against a single established contract. Each task order has its own scope of work and a stated “not to exceed” ceiling for dollars and DPLH incurred under the task. The different tasks issued under the contract may also have different funding

sources. Contractors are required to account for costs incurred under each task order separately as if they were separate contracts.

When scheduling vouchers for task order contracts, cost and fee should be recorded separately by individual task order and by contractor FY. The final voucher from the contractor should similarly be segregated by task. Also, total contract payments should be calculated and verified to DISCAS.

Typically, DCAA audit reports will only show total allowable costs for the entire contract and not for each individual task order. The voucher schedule, therefore, is crucial in using the final indirect rates for each year to calculate total allowable costs for each individual task. By calculating the final amount of cost and fee by individual task, a determination can be made as to whether the contractor had exceeded any of the task order ceilings.

The contracting officer may decide to allow overruns at the task order level. Many times, these overruns are attributable solely to indirect cost adjustments that would otherwise be reimbursable if not for the task order ceilings. Even though the contracting officer may decide to allow the task order ceilings to be exceeded, a calculation of the final adjustment must be done at the task order level because the different tasks under the contract will likely have different funding sources.

Quick Closeout

Background

Delays in closing out contracts are primarily attributable to delays in obtaining final indirect rates for those FY's closest to the expiration of the contract. According to a study by the Defense Contract Management Command, "waiting on final overhead rates" was the most frequently cited reason for delays in contract closeout, accounting for 26 percent of all physically completed contracts that are not yet closed.¹ Delays are encountered in (1) waiting on the contractor to complete their incurred cost submissions, (2) waiting on DCAA to complete audits on the submissions, and (3) waiting on the CFA to negotiate the rates and issue final rate agreements.

¹ Contract Management Magazine, August 1996

With quick-closeout, indirect rate adjustments must still be made but the adjustments are based on something other than DCAA audits.

Definition

FAR 42.708, “Quick-Closeout Procedures,” defines quick-closeout as:

“The contracting officer negotiating a settlement of indirect cost for a specific contract in advance of final indirect cost rates....”

The contracting officer and the contractor must bilaterally agree to the use of quick-closeout. The indirect rates that will be negotiated, commonly referred to quick-closeout rates, are applicable only to that particular contract and are in no way binding on any other contract.

Requirements

FAR 42.708 states that quick-closeout can only be used when the following occurs:

- The contract is physically complete.
- The amount of unsettled indirect costs to be allocated to the contract does not exceed \$1,000,000 per year.
- The amount of unsettled indirect costs to be allocated to the contract does not exceed 15 percent of total indirect costs of the contractor for a year.

At one time, DOE had a class deviation from the 15 percent limitation mentioned above and only the first two limitations applied. However, this class deviation expired in September 1997. The FAR allows a contracting officer to waive the 15 percent limitation, but not the first two. Therefore, as long as the first two limitations are met, the 15 percent limitation would not prevent the use of quick-closeout.

Quick-Closeout Process

After the contracting officer and the contractor mutually agree to the use of quick-closeout, there are several alternatives available for establishing quick-closeout rates. The contracting officer, or his/her designee (e.g., reviewer) should explore these alternatives and use the one that is most advantageous to the Government, but still be acceptable to the contractor. In many cases, contractors are willing to accept final indirect rate adjustments that are less than anticipated from an audit because they want to get paid for any final adjustments and fee retention as soon as possible.

As part of the quick-closeout process, the contracting officer will direct the contractor to submit a quick-closeout proposal. This proposal will include an explanation as to how the indirect rates will be established for the contract. In most instances, the establishment of indirect rates has been previously agreed to through preliminary discussions between the contracting officer, reviewer, and the contractor.

When exploring the alternatives for establishing the indirect rates, the first step in the process should be to contact the cognizant DCAA office. For some of the larger Government contractors, there may be quick-closeout rates already established which can be confirmed with the reviewers. Even if no such rates exist, the DCAA reviewers may, on a case-by-case basis, estimate indirect rates for quick-closeout purposes. DCAA recognizes the need for expediting the closing of certain low risk contracts prior to finalizing the indirect rates for the later years of these contracts. In these cases, DCAA will frequently recommend quick-closeout rates based on their knowledge of the contractors.² The DCAA reviewers may also provide information as to whether there are any outstanding audit issues that could have a significant impact on contract closeout. They can also advise as to whether it would be best to wait for all audits to be completed prior to closing out a contract.

For medium and small contractors, the preferable method of determining indirect rates is to conduct a desk review of the contractor's unaudited indirect cost proposals for the years being reviewed. This is especially the case with contractors that have no other Government contract work

² DCAA, Contract Audit Manual, Section 6-1009

other than the contract that is being closed. The purpose of the desk review is to ensure costs incurred during the contractor's FY's have been properly allocated and are allowable. This desk review will identify any indirect cost adjustments that will impact the indirect rates.

Another alternative for establishing indirect rates for the final years of the contract involves using the contractor's prior years' audit history. The final rates for the immediate previous year, or an average of final rates from the past several years may be used. As long as there is consistency in the indirect rates from year-to-year, after taking into account unallowable costs, the Government's risk of over reimbursing costs for the unaudited years is limited.

After the method for establishing indirect rates for quick-closeout purposes is agreed to, the contractor will submit a quick-closeout proposal with the final adjustment claimed. DOE will issue a written agreement stating the indirect rates, how they were arrived at, and that they are to be used solely for closeout of the contract in question. Prior to final payment, the contractor and contracting officer will sign this agreement. No adjustment will subsequently be made to other contracts for over or under recoveries of costs allocated to the contract covered by the quick-closeout agreement.

As with normal closeouts, the reviewer should ensure costs claimed are in accordance with any advance agreements in the contract, schedule vouchers, and prepare a closing statement. Also, when a contract has been closed using quick-closeout, notification should be sent to the cognizant DCAA office. DCAA charges DOE for their services based on the contracts covered in their report. Notifying the DCAA that the contract has been closed should prevent them from subsequently issuing an unneeded audit report and charging DOE for audit services.

All our discussions up to this point have focused on when to use the quick-closeout process. There are also occasions when quick-closeout should not be used. It should not be used if there has been a history of significant adjustments between costs billed during the year with costs claimed by the contractor in their incurred cost submission. Additionally, quick-closeout should not be used if prior audits reflect a history of significant questioned costs.

Closeout of Financial Assistance Awards

Background

Closeout of financial assistance awards with commercial entities, such as companies receiving Small Business Innovation Research Grant awards, can be quite difficult. These awards are frequently thought of as grants and not requiring the audit coverage afforded other contract types. However, FAR 31 cost principles apply to these awards. Closeout of these awards, therefore, requires that audits be conducted, incurred cost submissions be obtained, and indirect rate adjustments be made.

The closeout process for financial assistance awards to non-profit entities, educational institutions, and governmental agencies is relatively easy. The process places heavy reliance on the organizational-wide audits required by the OMB Circulars. Additionally, DOE does not have to wait until it receives all the audits covering all years of the financial assistance award before closing the award. DOE also retains the right to recover any disallowed costs resulting from a subsequent audit for up to 3 years past final payment.

Requirements

The DOE policies and procedures covering financial assistance awards are contained in 10 CFR §600. This and other guidance on financial assistance is available at the DOE, Office of Procurement and Assistance Management Web Page at <http://www.pr.doe.gov/fahome.html>.

Closeout requirements applicable to financial assistance awards to commercial entities, non-profit entities, and educational institutions are contained in 10 CFR §600.171-173. Closeout requirements for governmental entities are contained in 10 CFR §600.250-252.

Financial Assistance Closeout Process – Commercial Entities

Closeout of financial assistance awards with commercial entities should be planned for immediately after the award is made. As mentioned above, FAR 31 cost principles apply to these awards. Therefore, either DCAA audits are to be requested or desk reviews are to be completed, incurred cost submissions are to be obtained from the recipient, indirect rates are to be negotiated, and indirect cost adjustments are to be made.

The difficulty in closing out these awards relates to the payment method. Although the award is with a commercial entity, the payment methods for financial assistance awards apply. Recipients of these awards are paid in advance using electronic funds transfer as opposed to reimbursement using detailed vouchers. The recipients request payments by submitting Standard Form (SF) 270, "Request for Advance or Reimbursement" which does not provide a breakdown of costs. This standard Treasury Department form only shows the current amount requested and cumulative amount paid, without regard to the entity's FY. Each FY will have a different indirect rate.

The resulting problem for the reviewer is that voucher schedules by the commercial entity's FY cannot be prepared and the indirect rate adjustments cannot be determined by FY. In this situation, the reviewer typically must resort to verifying cumulative payments as shown on the final SF-270 to DISCAS and then comparing this to total allowable costs from all of the annual incurred cost audit reports. This process is difficult because variances cannot be identified to a particular year or cost category when attempting to resolve differences with the recipient in order to mutually agree on the final amount of costs incurred.

Financial Assistance Closeout Process – Non-Profit Entities

The annual organization-wide audit reports on non-profit entities will contain a CPA's opinion on the allowability of costs incurred under major Federal awards. These reports, however, typically do not contain sufficient information to derive and negotiate indirect rates. Non-profit entities are required to submit an indirect cost proposal to their CFA within 6 months after each FY. These proposals provide the information necessary for reviewing and negotiating indirect cost rates during the award and establishing final allowable costs incurred.

Financial Assistance Closeout Process – Educational Institutions and Governmental Entities

The closeout process described in 10 CFR §600.171-173 and 10 CFR §600.250-252 is similar and is applicable to the closeout of financial assistance awards with educational institutions, and governmental entities. These regulations state that the recipients should submit all financial reports required by the terms and conditions of the award

within 90-calendar days after the completion date. DOE can approve extensions to this reporting requirement when requested by the recipient.

The recipient should pay all outstanding obligations incurred under the award not later than 90-calendar days after the funding period or the date of completion stated in the award. A final SF 270 should be submitted for final payment. At this point, recipients should promptly refund any balance of unused funds that DOE has advanced. The key to closeout of financial assistance awards with educational institutions and Government entities is obtaining any available organization-wide audit reports. These reports should be read by the reviewer to identify any findings or questioned costs applicable to DOE awards. Also, cumulative obligations and payments on the final SF-270 should be verified to DISCAS and any variances resolved with the recipient. Failure to receive organization-wide audits for all years of the award, however, should not preclude its closeout since DOE retains the right to recover any disallowed costs resulting from a subsequent audit for up to 3 years past final payment. Additionally, should this occur, DOE would charge interest on the overdue debt in accordance with 4 CFR Chapter II, "Federal Claims Collection Standards."

Self-Test - Questions

1. Briefly describe when a cost reimbursement type contract is completely closed from a financial standpoint.
2. True or False--It is acceptable for a final voucher from a contractor to represent only a partial payment because other adjustments can be paid after the final voucher is processed.
3. What three procedures can reviewers use to verify contract documents and payments to DISCAS and aid the contracting officer in arriving at a mutually agreed upon final amount of allowable costs with the contractor at the time of closeout?
4. True or False--Contractors are usually timely in submitting their indirect rate proposals 6 months after their FYE as required by the FAR.
5. True or False--With quick-closeout, no adjustment for indirect costs needs to be made for the final year(s) of the contract.

Self-Test - Answers

1. Briefly describe when a contract is completely closed from a financial standpoint. **A cost reimbursement type contract is not closed until all administrative and financial actions have been completed. From a financial standpoint, all indirect rate adjustments must be made based on final negotiated rates and any disputes settled. Also, final payment, including fee retained, must be paid, and a final release of claims against the Government arising out of the contract must be signed by an officer of the contractor.**
2. True or False--It is acceptable for a final voucher from a contractor to represent only a partial payment because other adjustments can be paid after the final voucher is processed. **False. Upon receipt of the release of claims from the contractor, no further payments will be made for that contract for any reason.**
3. What three procedures can reviewers use to verify contract documents and payments to DISCAS and aid the contracting officer in arriving at a mutually agreed upon final amount of allowable costs with the contractor at the time of closeout? **Prepare analysis of the contract and all modifications, prepare a voucher schedule, and prepare a closing statement.**
4. True or False--Contractors are usually timely in submitting their indirect rate proposals 6 months after their FYE as required by the FAR. **False. A common misconception is that contract closeout is delayed due to DCAA not completing the incurred cost audit timely. In actuality, the contractors are not preparing acceptable incurred cost submissions on time usually cause the delay. DCAA's incurred cost audit cannot begin until an acceptable submission has been received. It is imperative that contractors be monitored to ensure these submissions are received timely.**

5. True or False--With quick-closeout, no adjustment for indirect costs needs to be made for the final year(s) of the contract. **False.** All indirect cost adjustments are made, they are just based on something other than a DCAA incurred cost audit.

